



INVALIDATION OF INSOLVENT DEBTOR'S TRANSACTIONS

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ABSTRACT

In this article is studied and analyzed legislation on invalidate transactions in the insolvency case. In addition to, developed recommendations related to improving the legal rules aimed at regulating the invalidation transactions in the insolvency case.

ПРИЗНАНИЕ НЕДЕЙСТВИТЕЛЬНЫМИ СДЕЛОК НЕПЛАТЕЖЕСПОСОБНОГО ДОЛЖНИКА

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ABSTRACT

В этой статье изучены и анализированы законодательные акты по признанию сделок недействительными в деле о неплатежеспособности. Кроме этого, разработаны рекомендации, связанные со совершенствования правовых норм, направленных на регулирование признания сделок недействительными в деле о неплатежеспособности.

It is known that transactions must comply with the rules established by civil legislation, which, in fact, ensures the stability and legality of civil legislation.

The procedure and grounds for challenging the debtor's transactions in insolvency (bankruptcy) cases are regulated by the rules of **Insolvency law** (The law passed 12th April of 2022). The possibility of providing creditors with special means of judicial protection against illegal (unfair) actions of the debtor to challenge transactions made by the debtor for the purpose of causing harm was laid down in Roman law. This mechanism firmly was established in the doctrine of the continental system of law, as a Paulina's claim, named after the Praetor Paulus, is in a slightly modified form and currently allows challenging the transaction only on the bases that it was made with the intent to cause damage to creditors. According to article 1167 of the current Civil Code of Napoleon, the Paulina's claim protects the creditor not from the debtor's omission, but from a legal action that reduces the debtor's property. The



consequences of Paulina's claim are not used by all creditors, but only by who has achieved recognition of the legal action as invalid. Only this creditor can take property that is the subject of a general pledge, the part that was restored as a result of satisfaction of its claim. Paulina's claim may be brought by the creditor only to protect its legitimate interests related to the threat of insolvency of the debtor. Thus, the purpose of filing a Paulina's claim is to prevent the debtor's insolvency. The invalidation of a legal action contested by filing a Paulina's claim depends (except in cases where gratuitous transactions are involved) on the bad faith of the person who entered into the contract with the debtor.

If this person was bona fide, then the property transferred under the contract and left the debtor's property cannot be withdrawn from the acquirer. Rene Savate ("Theory of Obligations") also cites such a possible case when the acquirer, who was an accomplice to the debtor's unfair actions¹.

What about retroactive consequences of opening insolvency proceedings, which entail a period of "*suspicion*". As a result, the bankruptcy trustee has the right to challenge transactions made by the debtor within the time established by law before the opening of insolvency proceedings. Thus, according to section 30-33 of the *German Insolvency Statute*, the trustee may challenge:

transactions entered into by an insolvent debtor to the detriment or with the intention of causing damage to the bankruptcy creditors after filing an application with the court or stopping payments, if the counterparty under such a transaction was aware of the termination of payments or the filing of an application;

transactions after the termination of payments or the filing of an application that provide benefits to one of the creditors;

compensation agreements made by the insolvent debtor during the year preceding the opening of bankruptcy proceedings with his immediate family and spouse;

gift agreements made by the debtor during the year before the opening of bankruptcy proceedings, except for those whose subject matter is an ordinary gift in certain cases;

gift agreements in favor of crimes committed within 2 years prior to the opening of bankruptcy proceedings, etc².

Similarly, deliberate actions of the debtor that cause harm to creditors may be challenged in court. The legal consequences are as follows: what was alienated from the debtor's property as a result of the disputed actions, given away, transferred (with the transfer of ownership rights), must be returned to the bankruptcy estate. Injunctions concerning unjustified enrichment, in which the beneficiary knew about the illegality of his actions, have the same force. In the Anglo-Saxon, legal system the ability to challenge the debtor's transactions is based on the provisions of the legal institution of trust property (trust). Thus, the liquidator, being a trustee, can challenge the transaction and demand the transfer of title to the property (primarily to real estate objects). A similar approach, regulated in the doctrine of "return relations" (relation back principle), is reflected, for example, in the *Australian Bankruptcy Act of 1966*. In accordance with Sections 544-549 of the *American Bankruptcy Act of 1978*, effective

¹ Саватье Р. Теория обязательств. Юридический и экономический очерк. М.: Издательство «ПРОГРЕСС», 1972

² Insolvency statute of Germany. http://www.gesetze-im-internet.de/englisch_inso/



from October 1 Since 1979 and completely replacing the *Nelson Act of 1898*, the bankruptcy commissioner (corresponding to the concept of “arbitration manager”) is able to challenge the debtor’s transactions made to the detriment of creditors within a year before filing a petition for declaring the debtor bankrupt.

In the post- Soviet legal space, the possibility of claiming the property of a debtor transferred before the insolvency case is initiated is also fixed at the legislative level. According to *the Kazakhstan’s law*, if it is impossible to claim property due to its loss, damage or subsequent bona fide acquisition by third parties, the original purchasers of the property being claimed are liable to the debtor for compensation of losses incurred in this regard within the value of the property lost, damaged or bona fide acquired by third parties³.

Transactions made by the debtor or other persons at the expense of the debtor may be declared invalid in accordance with the Civil Code of the Uzbekistan, as well as on the grounds and in accordance with the procedure specified in the Insolvency Law.

Provided for in chapter VI of the Insolvency Law, the procedure for declaring transactions invalid should be considered as a special measure, which is an integral part of a set of measures aimed at protecting the rights of the creditor through involvement in legal proceedings.

According to Uzbek law, invalidity of transactions made by the debtor or other persons at the expense of the debtor should be considered with:

- 1) general grounds for invalidity established by the Civil Code of the Russian Federation;
- 2) the grounds provided for by the Insolvency Law (the so-called special grounds of invalidity).

The establishment of special grounds for the invalidity of transactions is one of the manifestations of the specifics of the institution of invalidity in insolvency law, which, on the one hand, provides for the need to use general civil grounds for the invalidity of transactions, and on the other hand, highlights special, non – traditional for civil legislation, defects in transactions that acquire legal significance, as a rule, only within the framework of insolvency relations. In reality, there are often cases of transactions that do not comply with the rules established by civil law.

All transactions that can be declared invalid, are divided into three types: **unequal, suspicious and preferred**⁴.

Unequal transactions include transactions made **within one year** prior to the acceptance of the application for declaring insolvency or after the acceptance of the specified application may be declared invalid by the court if the other party to the transaction performs an unequal counter-performance. For example, if the ***price significantly differs from the price for similar transactions***;

Suspicious transactions are considered **within three years** prior to the adoption of the application for declaring the debtor bankrupt or after the adoption of the said application may be declared invalid by the court if they were made for the purpose of causing harm to the property rights of creditors. The purpose of causing harm assumes that the ***other party is an***

³ The Law of Rehabilitation and bankruptcy of Kazakhstan.

https://online.zakon.kz/Document/?doc_id=31518958#pos=165:-54

⁴ Kuznetsov S. A. Problemy vosposobaniya deksii dolzhnika [Problems of disputing the debtor's transactions]. 2010. No. 3. p. 104.



interested party in the transaction, *or the party knew or should have known about the infringement of the interests of creditors or about the existing signs of the debtor's insolvency.*

Preferred transactions include:

- transactions that may or may result in preference to one creditor over the others and were made **within one month** prior to the acceptance of the application or after the acceptance of the application for declaring the debtor bankrupt. In this case, the transaction must result in either *other creditors, or one of the creditors is preferred to satisfy the claims that existed before* the contested transaction was *completed, compared to the priority* of creditors.
- transactions made **within six months** prior to the court's acceptance of the application for declaring the debtor bankrupt may be declared invalid. If the following conditions are met: the basis for invalidation is the *focus of the transaction on securing an obligation that arose prior to the disputed transaction, or the transaction has led or may lead to a change in the order of satisfaction of the creditor's claims for obligations, the creditor or other person in respect of whom the transaction* was made was aware of the signs of the debtor's insolvency, the presence of debt to other creditors and the debtor's property insufficiency to meet the requirements.

It can be pointed out that in the legal literature it is customary to distinguish two forms of invalidity of transactions that caused damage to the creditor: the first type – recognition of the invalidity of transactions in their pure form, and the second type – recognition of actions that led to a decrease in the bankruptcy estate of the debtor. It is necessary to study in more detail the first type of theories of the legal nature of invalidity of transactions, since this type is most common in insolvency, both for individuals and legal entities.

The first theory is **tort**. The main idea of this theory is that the basis for refuting this transaction is the commission of an offense. The tort must be committed directly by the debtor and its counterparty, and the damage must be caused to the rights of the creditor.

The second theory is "legal". This theory also has the second name "**theory of exclusive protection of the interests of creditors' rights**". The essence of this idea is that in the interests of the creditor, there is an obligation relationship between the creditor and the person who acquired the property. Under this relationship, the creditor may claim property acquired by a third party. According to this theory, the basis for challenging this transaction is the emerging obligation of a special kind. However, this theory also has its weaknesses. Thus, this theory establishes as the basis for challenging a different obligation, which cannot be qualified as a contract or an offense. We can say about the third theory is the theory of executive power. The core of this theory is that the right of refutation is an auxiliary means of executing a court decision, and the execution directed to the debtor's property also applies to valuables that have left the debtor's possession and at the expense of which the creditor could satisfy its legal claims. This theory is based on the idea that it denies binding relations between both creditors and third parties.



According to M.Y. Tikhomirov, the concept of an affiliated person implies the existence of relations not so much property as managerial dependence between subjects, which provides for a certain degree of influence on the activities of management bodies⁵.

Affiliated parties in relation to the debtor – legal entity are also recognized as: head of the debtor, as well as members of the Board of Directors (Supervisory Board), the collective Executive body or other authority control of the debtor, the chief accountant (accountant) of the debtor, including such persons, released from their duties during the year prior to the commencement of the bankruptcy case, as well as persons with these individuals is related.

N. Kostyuk proposes to define good faith applied in civil law as a set of subjective and objective elements: the subjective side of a person's behavior (lack of intent or carelessness in relation to the actions performed), which is objectively manifested in the fact that it has taken all appropriate measures to establish the counterparty's authority to make a transaction with the degree of care and prudence that was required of it by the nature of the legal relationship⁶.

This rule contains a general rule and a refutable presumption: the participants' good faith is assumed until proven otherwise.

When deciding whether the creditor should have known about the debtor's difficult financial condition (signs of insolvency, insufficient property), information is taken into account on how much he acted reasonably and showed the prudence required of him under the terms of turnover. The factors that indicate the knowledge of the creditor about the signs of insolvency and property insufficiency, judicial practice includes:

- repeated application of the debtor to the creditor with a request to postpone or installment the debt due to the inability to pay it within the originally established period (for example, repeated sending of an application for loan restructuring to the bank);
- the creditor's knowledge that the debtor has applied for recognition as a creditor and other factors.

Tax authorities and credit institutions are particularly protected by legislation and court explanations. The fact that the other party to the transaction is a credit institution or a tax authority is not sufficient to conclude that it is aware of the signs of the debtor's insolvency. However, the awareness of a credit institution or tax authority may be indicated by the debtor's financial statements, which clearly indicate signs of its insolvency.

The consequences of invalidity of transactions of an insolvent debtor reflect the specifics of such transactions are special and assume, on the one hand, the obligation of the debtor's counterparty to return what was received from the debtor.

On the other hand – satisfaction of the claim against the debtor for the return of the proceeds received under an invalid transaction in the order and order established by the Insolvency Law. These consequences also do not exclude the cumulative application of damages and condition claims.

Special consequences of the invalidity of transactions of an insolvent debtor do not exclude the restorative nature of mandatory protective legal relations arising in connection with the application of these consequences. These legal relations have all the elements of a

⁵ Tikhomirov M. Y. Committing interested-party transactions and large transactions by a Limited liability company. *Zakonodatelstvo i ekonomika [Legislation and Economics]*. 2010. No. 9. pp. 35-36.

⁶ Kostyuk N. Conscientiousness in Russian and foreign civil law // *Economy and law*. 2008. No. 12, p. 104.



restorative legal relationship. The content of such legal relations is a set of subjective restorative rights (claims) and obligations of the insolvent debtor and its counterparty under an invalid transaction.

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